CONSUMER BANKERS ASSOCIATION

September 17, 2020
VIA Electronic Submission

Robert E. Feldman, Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

RIN 3064-ZA18

Re: Request for Information ("RFI") on Standard Setting and Voluntary Certification for Models and Third-Party Providers of Technology and Other Services

The Consumer Bankers Association[1] ("CBA") applauds the FDIC's efforts to promote the efficient and effective adoption of technology at FDIC-supervised banks and to facilitate the supervision of technology usage at these institutions without increasing costs or regulatory burden. Due to the COVID-19 pandemic, the banking industry has been pushed to more quickly innovate and modernize to better serve the needs of consumers. The possibility of a voluntary standard offers a potentially promising prospect to assist banks with streamlining their efforts to innovate and modernize.

As the FDIC notes in its preamble to the RFI, banks establish relationships with third-parties to provide certain functions or to meet short-term needs. As a result, risk management departments are tasked with identifying and controlling risks associated with these third-party arrangements. However, CBA would also highlight the cost prohibitive nature of managing third-party risk is only particularly troublesome for community banks. CBA urges the FDIC to develop a framework useful for banks of all sizes and complexities. For example, if the risks are determined acceptable for community banks, then, the same approval should be extended to other banks.

The remainder of this letter offers responses to select questions from the FDIC's RFI.

General

What are the advantages and disadvantages of establishing standard-setting and voluntary certification processes for either models or third-party providers?

CBA agrees assessing third-party models is challenging due to limited or non-access to data or functional form. As a result, banks are forced to rely on reduced scope tests and to implement stronger controls, where possible. In turn, this inherently heightens the risk level.

As a potential advantage, a standard-setting organization ("SSO") could help facilitate a culture of transparency amongst third-parties. The SSO could either facilitate the review and/or partnership with banks, or the SSO could serve as the assessor of those third-parties.

[1] The Consumer Bankers Association partners with the nation's leading retail banks to promote sound policy, prepare the next generation of bankers, and finance the dreams of consumers and small businesses. The nation's largest financial institutions, as well as many regional banks, are CBA corporate members, collectively holding two thirds of the industry's total assets.

In contrast, the SSO could reduce the competitive advantage if some banks are better at managing vendors, third-parties, and/or third-party models. The SSO could trigger additional expectations across the banks. For example, the SSO may review elements and implement procedures not previously exercised by the bank.

What are the advantages and disadvantages to providers of models of participating in the standard-setting and voluntary certification process? What are the advantages and disadvantages to providers of technology and other services that support the IDI's financial and banking activities of participating in the standard-setting and voluntary certification process?

The SSO could serve as open-transparent type marketplace or ticketing system for review of third-parties. This would prevent banks from independently negotiating, and they could assess which vendors are more cooperative.

As a potential disadvantage, if evidence, procedures, standards for gaining comfort within the financial institution's control environment are not consistent across organizations then model providers will be responding both to financial institutions and SSO. This structure could result in less efficiency. Therefore, consensus on certification standards is critical.

Are there specific challenges related to due diligence and ongoing monitoring of such third-party providers?

For models, CBA members have found each vendor is different when it comes to transparency. Banks also may not be able to see changes in models. For example, model changes may not trigger a vendor to release a new version, and the version release notes often do not list model changes. Changes to models are essential to going monitoring because it dictates how rigorous a bank should monitor the third-party.

Are there specific challenges related to the review and validation of models provided by such third-parties?

Yes. For example, interagency regulatory guidance, SR 11-7[2], specifically highlights the challenge of validating third-party models. As a result, banks have to do alternative testing or limited testing. In addition, legal contractual issues are also likely to arise from vendors who are less accustomed to working with financial institutions.

Are there specific challenges related to information sharing or data protection?

Yes. For example, models related to credit, marketing or where bias or fairness are of concern, or models which may use onpublic personal information.

[2] https://www.federalreserve.gov/supervisionreg/srletters/sr1107.htm.

Would a voluntary certification process undermine innovation by effectively limiting an insured depository institution's ("IDI's") discretion regarding models or third-party providers of technology and other services, even if the use of certified third-parties or models was not required? Would IDIs feel constrained to enter into relationships for the provision of models or services with only those third-parties that are certified, even if the IDIs retained the flexibility to use third-parties or models that were not certified?

Not necessarily, CBA members believe banks gaining confidence in the certification process is a larger hurdle. For example, if the voluntary certification is created, the bank then has to decide how to incorporate it into their internal process, whether to exclusively rely on the certification, or is it a combination of both options. As the voluntary certification matures, there may be more of an appetite to start with models included in the certification library.

What supervisory changes in the process of examining IDIs for safety and soundness or consumer protection would be necessary to encourage or facilitate the development of a certification program for models or third-party providers and an IDI's use of such a program? Are there alternative approaches that would encourage or facilitate IDIs to use such programs?

To facilitate broad use, the process should consider all applicable governing regulatory guidance and bodies which relate to models and third-party governance. CBA suggests the FDIC work through the FFIEC to apply to all federal and state bank regulators, since this issue impacts banking organizations of all charter types. However, if the voluntary certification is funded through FDIC insurance assessments, the certification should only be available to insured institutions.

<u>Scope</u>

For which types of models, if any, should standards be established and a voluntary certification process be developed? For example, is the greatest interest or need with respect to:

- *(1) Traditional quantitative models?*
- *(2) anti-money laundering (AML) transaction monitoring models?*
- *(3) customer service models?*
- *(4) business development models?*
- *(5) underwriting models?*
- *(6) fraud models?*
- *(7) other models?*

All of the above. However, traditional quantitative and underwriting models are most familiar to the banks and less likely to receive substantial benefit from the SSO. CBA believes the certification should be risk-based to consider the differences in risk between the models. As an additional thought, the certification could offer various levels. Vendors with a higher certification level would be more preferable. A tiered system would also allow vendors to perform a more targeted cost/benefit analysis when deciding to certify.

Which technical and operational aspects of a model would be most appropriate for evaluation in a voluntary certification program?

CBA believes governance and compliance risks should be prioritized in an evaluation for a voluntary certification program. In addition, with the rise in the use of artificial intelligence and machine learning, the FDIC must also prioritize data and bias review.

What are the potential challenges or benefits to a voluntary certification program with respect to models that rely on artificial intelligence, machine learning, or big data processing?

As a potential benefit, vendors would have an expectation the details of their products would be viewed by third-party non-customers. This would also better prepare the vendors for partnership with financial institutions. Essentially, the voluntary certification may have the ability to lift the veil of secrecy previously shrouding information vendors deem proprietary.

As a potential challenge, due to regulatory requirements, banks would still be tasked with similar work. Thus, CBA urges the FDIC to develop a framework which offers banks regulatory relief when working with certified vendors.

<u>SSO</u>

If the FDIC partnered with an SSO to set standards for due diligence and assessments of models or third-party providers of technology and other services, what considerations should be made in choosing the SSO? What benefits or challenges would the introduction of an SSO into the standard-setting process provide to IDIs, third-party providers, or consumers?

A potential idea would have the SSO operate as a marketplace facilitator with transparency across the banks. However, it is unclear if the banking industry would adopt this model. As a related example, Apache, the open source software , issue resolution is open and public. As a consequence, there was a licensing issue for intellectual property between Facebook and Apache which led to changes in how Facebook published and licensed open-source software.

To what extent would a standards-based approach for models or third-party providers of technology and other services be effective in an environment with rapidly developing technology systems, products, and platforms, especially given the potential need to reassess and reevaluate such systems, products, and platforms as technologies or circumstances change?

CBA believes as a part of the FDIC's voluntary certification framework, there needs to be a cadence to reassess standards and certifications. The FDIC should clearly communicate the timing to financial institutions. The periodic review should include changes to the model, control environment, and any emerging changes. The framework should also prioritize transparency to ensure financial institutions can understand the certification process and rely on the output.

What current or draft industry standards or frameworks could serve as a basis for a standard-setting and voluntary certification program? What are the advantages and disadvantages of such standards or frameworks? Do standards and voluntary certifications already exist for use as described herein?

In regards to models, CBA recommends the FDIC begin with referencing interagency guidance, SR 11-7, which has a list of requirements for potential vendors.

Certification Organizations (COs)

What benefits and risks would COs provide to IDIs, third parties, and consumers?

CBA believes a CO could result in better efficiency n review models and facilitating interactions with model providers. Ultimately, this would assist with innovation within financial institutions.

For model validation and testing, would COs evaluate a model based solely on reports, testing results, and other data provided by the third-party provider of the model? Or would the COs need to test the model and generate their own test results? What steps would the COs need to take to protect the intellectual property or other sensitive business data of the third-party that has submitted its model to the validation process?

Ultimately, banks may still need to do their own testing. For example, various models may be customized, assessed for potential risks during implementation and/or receive a high risk rating based on a bank's internal procedures.

Conclusion

CBA supports the efforts of the FDIC to assist banks with modernizing and innovating within their institutions. First, we urge the FDIC develop a framework which is not only beneficial for community banks, but a program larger institutions qould also find useful. CBA also believes coordinating through the FFIEC would offer maximum efficacy for this type of program and would significantly modernize the banking industry. Lastly, as the FDIC develops a voluntary certification standard, it should also consider how this type of standard could offset the regulatory burden on banks in regards to third-party risk.

If you have any additional questions or concerns, please do not hesitate to contact André Cotten at 202-552-6360 or at Acotten@consumerbankers.com.

Sincerely,

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